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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1969

No. 583

D. B. ANDERS,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Tenth Circuit entered in the above-entitled case on June 20, 1969, rehearing denied on August 6, 1969.

CITATION TO OPINION BELOW

The opinion of the Tax Court of the United States, printed in Appendix B-1 hereto, infra, Page A3, is reported at 48 TC 815. The opinion of the Court of Appeals for the Tenth Circuit, printed in Appendix B-2 hereto, infra, Page A18, is reported in ..... F.2d ..... (69-2 USTC, Para. 9478) (24 AFTR 2d, Para. 69-5043), rehearing denied at ..... F.2d ..... (69-2 USTC, Para. 9573), printed in Appendix B-3, Page A28, infra.

JURISDICTION

The judgment of the Court of Appeals was dated and entered June 20, 1969, Appendix B-2, Page A18, infra. Petitioner's timely petition for rehearing was denied on August 6, 1969, Appendix B-3, Page A28, infra. The jurisdiction of this court is invoked under 28 USC Sec. 1254(1) and 26 USC Sec. 7482(a). The jurisdiction of the Tax Court of the United States was based on 26 USC Sec. 7442 and 26 USC Sec. 6212 as an action for the redetermination of a deficiency in income taxes previously determined by the Commissioner of Internal Revenue.

QUESTION PRESENTED

Whether the Court of Appeals for the Tenth Circuit erred in holding that certain of a corporation's gain from the sale of rental property did not qualify for the non-recognition provisions under Sec. 337 of the Internal Revenue Code of 1954 where:

(1) The corporation had consistently charged to its expense accounts when purchased the cost of the property used in conducting its industrial laundry rental business;

(2) At the end of each taxable year the corporation credited the expense account with the cost of the ending

inventory of property which had not been placed in use at the end of such taxable year; and

(3) The aforesaid accounting method used by the corporation was not challenged by the Internal Revenue Service for the taxable year in question, nor for prior taxable years.

STATUTE INVOLVED

The statutory provision involved is Sec. 337(a)(b) and (c) of the Internal Revenue Code of 1954, 26 USC, Sec. 337(a)(b) and (c), 68A Stat. at Page 106. Said statute is printed in Appendix A-1, infra, Pages A1 to A3, inclusive.

The regulation involved is Reg. Sec. 1.337-3(a), 26 CFR, Sec. 1.337-3(a), Page 69. Such regulation is printed in Appendix A-2, infra Page A3.

STATEMENT OF CASE

Petitioner commenced this action in the Tax Court of the United States under 26 USC Sec. 7442 and 26 USC Sec. 6212 for the redetermination of a deficiency in income taxes for the year ended July 31, 1961, as determined by the Commissioner of Internal Revenue.

In the notice of deficiency, the respondent determined a deficiency in income taxes of D. B. Anders, Inc., for the taxable year ended July 31, 1961, in the amount of $121,160.00 and he notified Petitioner that the deficiency and interest, constituting the Petitioner's liability as the transferee of assets of the corporation, would be assessed against the Petitioner. (The Petitioner admits that he stands in the shoes of D. B. Anders, Inc., insofar as any determination of the income tax issue involved in this case is concerned.) The Petitioner owned all of the stock of Service Industrial Clean-

ers, Inc., a Kansas corporation which in 1961 changed its name to D. B. Anders, Inc. (hereinafter referred to as "Service" or the "Corporation").

Prior to 1951, Service's business consisted primarily of the laundering of industrial uniforms and other items belonging to its customers, which type of business is referred to in the trade as "NOG," meaning "Not-Our-Goods." (R 95, 96). Service began the rental business of garments and other property in 1951 (R 96). The corporation was engaged in the business of conducting and providing a rental service of cleaned and laundered towels, seat covers, fender covers, wiping materials and dust cloths, coats, coveralls, shirts, pants and other textiles and apparels, including dusting and wiping equipment, sweeping tools, mops and accessories, as well as conducting a cleaning and laundering service of substantially the same types of property owned by others. In the taxable year ended July 31, 1961 (prior to May 1961 when the corporation sold its assets), some eighty to eighty-seven percent of the corporation's business was attributable to laundry-rental business (R 35-36, 46-47).

Service's garment rental business consisted of furnishing laundered shirts, trousers, coveralls and related items to its customers on a periodic basis (Exhibits 10, 11, 12). Its principal garment customers were General Motors, Ford Motor Company, Trans-World Airlines, Bendix and industries of that type. In addition, garment service was provided for such customers as garages, florists, cemeteries, filling stations, motor car dealers and small manufacturers (R 96, 98, 147). In 1961, Service had approximately 40,000 garments in circulation in its rental business (R 103, 104).

Service's shop towel rental business consisted of furnishing laundered shop towels to its customers on a pe-

riodic basis. Shop towels are made of absorbent cotton material and are used in industry for wiping oil and greases (Exhibits 13, 14, 15; R 97). Its principal shop towel customers were railroads, pipe lines and industries of that type (R 97). Service's principal railroad customer was the Union Pacific Railroad which was serviced on a system-wide basis from Service's plant in Kansas City (R 98).

For Federal income tax purposes, Service charged to its expense accounts when purchased the cost of the garments and other property used in conducting its industrial laundry rental business. At the end of each taxable year, the expense accounts were credited with the costs of the ending inventories of property which had not been placed in use at the end of such taxable year (R 36, 37, 137, 138). Service's annual replacement costs of garments and other property used in the rental business averaged approximately $200,000.00 per year (R 100, 48, 41).

The previously mentioned accounting method used by Service in accounting for replacement costs for Federal income tax purposes was not challenged by the Internal Revenue Service for the taxable year ended July 31, 1961, nor for prior taxable years (R 61, 141). Service had a zero basis in these assets (R 142). Other assets involved in the sale to be hereinafter mentioned also had a zero basis (R 143).

On May 16, 1961, Service entered into an "agreement of sale" with four individuals for the sale of the assets of the business, including patronage and goodwill, for the total sum of $509,500.00. The parties agreed that this did not include new, unused and unwashed garments and rental property and that there would be added to the price an amount equal to the seller's cost of such property (R 49-50).

The sale by Service of its assets was completed on or about May 22, and 23, 1961 and pursuant to a plan of liquidation adopted by Service, the corporation distributed all of its assets in complete liquidation to the Petitioner, its sole stockholder, within the 12-month period beginning May 12, 1961. In April, 1962, the corporation filed a resolution of dissolution with the Secretary of State of Kansas and its corporate existence ceased (R 38, 50).

On its income tax return for the fiscal year ended July 31, 1961, the corporation reported a gain of $446,601.89 arising out of the sale of the assets to the buyers and it claimed exclusion of such gain from taxable income under Sec. 337 of the Internal Revenue Code of 1954. The amount of gain reported, and for which exclusion from taxation was claimed, included $233,000.00 as the amount of the consideration received under the terms of the sales agreement by Service allocated to the rental property in use at the time of sale (R 51).

The Tax Court found in favor of the Petitioner, stating that the sole issue was whether in a liquidation under Sec. 337 of the Internal Revenue Code of 1954, the corporation is entitled to the nonrecognition of gain on property, the cost of which had previously been deducted as an expense. The respondent duly perfected an appeal to the Court of Appeals for the Tenth Circuit, which court reversed, finding as a matter of law that the so-called tax benefit rule precluded nonrecognition under Sec. 337 of the Internal Revenue Code of 1954, such judgment being entered on June 20, 1969. The Petitioner thereupon filed a timely petition for rehearing which was denied by the Court of Appeals on August 6, 1969 (Appendix B-3, infra, Page A28).

REASONS FOR GRANTING THE WRIT

The question presented, i.e., whether the entire amount of the gain realized by Service on the sale of its assets to the buyers is properly excluded from taxable income, as the clearly expressed intention of Congress, under Sec. 337 of the Internal Revenue Code, as Petitioner contends; or whether a portion of the gain realized, namely the $233,000.00 realized from the sale of the tangible personal property then in use in the corporation's rental business, is includible in income by reason of the creation of a judicial exception to Sec. 337, notwithstanding the clear language of that statute (namely the "tax benefit rule"), is an issue which is of significant national importance. This case is a case of first impression and settlement of the question by this court is plainly in the public interest, since it is currently involved in numerous proceedings both before the Internal Revenue Service and in the various courts which have jurisdiction of income tax matters as is shown by the following table of pending matters:

Case Name	Status Before Court Or Before Internal Revenue Service	Amount In Issue
1. *Spitalny* v. *U.S.*, 288 F. Supp. 650 (D. Ariz. 1968)	Appeal pending before United States Court of Appeals for Ninth Circuit.	$110,409.71
2. *S. E. Evans, Inc.* v. *U. S.*, No. FS-69-C-27 (W. D. Arkansas)	Pending on motions for summary judgment filed on behalf of both plaintiff and defendant.	$102,377.34
3. *Steel Parts Corporation* v. *C.I.R.*, Tax Court Docket No. 2085-69	At issue and ready for trial before Tax Court of the United States.	$599,538.99

4. *Estate of Henry Sagemuller*	Pending on district conference before District Director, Omaha, Nebraska.	$16,552.61
5. *Donzel D. Bowman, et al.*	Pending on district conference before District Director, Omaha, Nebraska.	$9,508.07
6. *Gritsch Corporation*	Claim for refund disallowed by IRS San Francisco, California office September 1968.	$17,004.00

In addition, the opinion of the Court of Appeals has departed so far from the accepted and usual course of judicial proceedings as to call for an exercise of this court's power of supervision, i.e., namely the Court of Appeals has created a judicial exception to a clear and unambiguous statute and regulation. Section 337 of the Internal Revenue Code of 1954, 26 USC Sec. 337, first enacted in 1954, provides that if a corporation adopts a plan of complete liquidation on or after June 22, 1954, and within a 12-month period beginning on the date of the adoption of the plan, all of the assets of the corporation, less those retained to meet claims, are distributed in complete liquidation, then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

The purpose of the inclusion of Section 337 in the 1954 Code was to deal with the so-called "Court Holding Company" problem. Prior to the enactment of Section 337 if a sale of assets was made in connection with the liquidation of a corporation, it was necessary to determine whether the sale was made by the corporation, in which case liabilities for two income taxes, one on the corporate level and one on the shareholder level, were incurred, or

whether the assets were first distributed to the shareholders and the sale made by the shareholders themselves, in which case only the shareholder's tax applied. The purpose of Section 337 was aimed at eliminating the uncertainties attendant upon the Supreme Court decision in *Commissioner* v. *Court Holding Co.*, 324 U.S. 331 (1945), and *United States* v. *Cumberland Public Service Co.*, 338 U.S. 451 (1950). The enactment of Section 337 was to make moot the question as to whether a sale of assets was accomplished by the corporation or its stockholders. See *Frank W. Verito*, 43 T.C. 429, 437-39 (1965).

There is no dispute in this case with respect to the facts attendant to the complete liquidation of Service. On May 12, 1961, Service adopted a plan of liquidation pursuant to Section 337 of the Internal Revenue Code (R 37, 176). Subsequent to the adoption of the plan, on May 16, 1961, Service entered into an agreement of sale with Albert Gitlow, Abraham Gitlow, Ben E. Singer, and Joseph L. Fradkin, acting in behalf of Service Industrial Cleaners, Inc., a Kansas corporation formed on May 17, 1961 (the Buyer), for the sale to Buyer of substantially all the assets of Service (R 37, 188). Pursuant to said agreement Service sold to Buyer on May 22 and 23, 1961, substantially all its assets including its plant and office equipment, real estate, goodwill, its entire inventory of garments, shop towels, fender and seat covers, and dust control items in use in its laundry rental business, its accounts receivable, and its inventory of new articles which had not yet been placed in service to the customer (R 38, 188).

The decision of the Court of Appeals for the Tenth Circuit necessarily is founded solely on its so-called "tax benefit theory." It is apparent from examining Exhibits 10 through 18 that the corporation sold tangible personal property. If as this court has recently stated, the words

of statutes, including revenue acts, should be interpreted where possible in ordinary everyday sense, the term "property" as used in Section 337 certainly embraces tangible personal property. *Malat* v. *Riddell*, 383 U.S. 569 at 571 (1966). Furthermore, the technical definition of property set out in Sec. 337 and the regulation promulgated thereunder is equally persuasive. Section 337 defines "property" by a process of exclusion. Section 337(b)(1) states that, for the purpose of the nonrecognition of gain provision of Section 337(a), the term "property" does *not* include:

> "(A) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business,
>
> (B) installment obligations acquired in respect of the sale or exchange (without regard to whether such sale or exchange occurred before, on, or after the date of the adoption of the plan referred to in subsection (a)) of stock in trade or other property described in subparagraph (A) of this paragraph, and
>
> (C) installment obligations acquired in respect of property (other than property described in subparagraph (A)) sold or exchanged before the date of the adoption of such plan of liquidation."

The legislative history of Section 337 does not contain any discussion of the term "property" beyond the basic statutory definition. 3 U.S. Code Cong. & Adm. News 4244, 4896 (83rd Cong., 2d Sess. 1954). Petitioner, in his Regulations, U.S. Treas. Reg., Sec. 1.337-3(a), defines "property" as follows:

> "(a) Except as provided in section 337(b)(2) and this section, the term 'property' as used in section

337(a) and section 1.337-1 does not include, (1) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business (hereinafter for purposes of section 337 referred to as 'inventory'), (2) installment obligations acquired at any time from the sale or exchange of inventory, or (3) installment obligations acquired from the sale or exchange of property (other than inventory) prior to the adoption of the plan of liquidation. *With the exceptions listed in this paragraph, the term 'property' includes all assets owned by a corporation.*" (Emphasis supplied). (Adopted 12 2/55 by T.D. 6152).

The installment obligations exception of Section 337(b)(1)(B) and Section 337(b)(1)(C) clearly have no applicability to the case at bar. It is clear that the Court of Appeals does not find that any of the exceptions to the statutory definition of the word "property" are applicable to the Petitioner. Furthermore, even if such exceptions were applicable, under the specific provisions of Sec. 337 a disposition of such assets in a sale in one transaction precludes recognition of gain and such property, even though inventory, et cetera, is included as property. Sec. 337(b)(1)(A). This exception for so-called bulk sales of inventory was added by the Senate so that Sec. 337 "more nearly corresponds to the results that would follow a sale of all the corporate assets (including the inventory) and the sale of all the stock." S.Rep.No. 1622, 83rd Congress, 2nd Sess., 1954, 3 U.S. Code Cong. and Adm. News 4621, at 4680.

In addition, no contention was made by the Court of Appeals that there had not been a "sale" of such assets and under a decision of this court there could be little

doubt that there was a sale since a sale in the ordinary sense of the word, is a transfer of property for a fixed price in money. *Commissioner of Internal Revenue* v. *Brown*, 380 U.S. 563 (1965). Thus, the Court of Appeals really ruled in the instant case that property was sold in a duly executed Sec. 337 liquidation and sale but that by reason of the "tax benefit rule," Sec. 337 need not be followed. The gist of the Court's opinion is contained in the revision to its opinion which resulted from the Petitioner's petition for rehearing where the Court states at modified Page 3 of its opinion:

> ". . . We conclude that the fact that a transaction involves the disposition of property within the meaning of Sec. 337 does not compel treatment of the proceeds from it as gain from a transfer of the property. . . . Where the cost of the property was fully expensed and deducted for tax purposes, tax benefit principles reasonably call for treatment of the proceeds as recoupment of the prior charges and ordinary income. By Sec. 337 Congress showed no intention to discard such principles."

The decision which is usually relied upon as a basis for the tax benefit rule is *Dobson* v. *Commissioner*, 320 U.S. 489 (1943). If *Dobson* be the parent of child known as the "tax benefit rule," then apparently the parent does not acknowledge the child. In the course of the *Dobson* opinion this Court stated at Page 506:

> ". . . We are not adopting any rule of tax benefits."

Despite this express disclaimer, the Court of Appeals in the instant case applied the tax benefit rule as an unwavering principle of law which must be followed even in the face of express unambiguous language from Congress. As clearly indicated in the previous quotation from *Dobson*, there is no such rule. Other Courts of Appeal

have also clearly indicated that there is no such rule. In *Reynolds* v. *Boos*, 188 F.2d 322 (8th Cir. 1951) the court stated at Pages 325 and 326 as follows:

> "What it apparently is here sought to get established is an absolute rule of liability in any case of tax benefits. Individual situations may perhaps exist where a liability soundly can be found to be present because of some previous tax benefit, but there is no such general or blanket principle of tax liability. The Supreme Court specifically said in *Dobson* . . . 'We are not adopting any rule of tax benefits.'"

Furthermore, if the respondent's position and the position of the Court of Appeals is to be consistent, the tax benefit theory must mean that one would always lose depreciation in the year of sale in a Sec. 337 liquidation. If this were not the case, the taxpayer would receive a "tax benefit" for which he received reimbursement in the year of sale. However, this court has refused to follow that theory in a Sec. 337 liquidation. *Fribourg Navigation Company, Inc.* v. *Commissioner of Internal Revenue*, 383 U.S. 272 (1966). Petitioner submits that the rationale of *Fribourg* is that since prior to the adoption of Sec. 1245 of the Internal Revenue Code in 1962, Congress had not provided for the recapture of depreciation in the year of sale, and since Sec. 337 provided for nonrecognition on the gain of the sale of assets, it necessarily followed that if useful life and salvage value were correct, then depreciation must be allowed in the year of sale. The gist of the *Fribourg* case as stated in 383 U.S. at Page 285 is:

> ". . . For post-1962 transactions Sec. 1245 applies to the situation which occurred in the instant case and would produce greater revenue. The taxpayer must report as ordinary income *all* depreciation recouped on sale, and this notwithstanding that the sale was part of a nonrecognition liquidation within Sec. 337. . . ." (Emphasis that of Court).

In short, Congress has specifically provided by statute that all gain on the sale of property owned by a corporation involved in a Sec. 337 liquidation (including even inventory and property held for sale if sold in one transaction) benefits from Sec. 337 in the sense that no gain is recognized by the corporate taxpayer. The only exclusions are those expressly stated in the statute such as inventory sold in more than one transaction. Furthermore, the regulation promulgated pursuant to that statute quite clearly follows the statute and concludes with the statement "with the exceptions listed in this paragraph, the term 'property' includes all assets owned by a corporation." Reg. 1.337-3(a). The Petitioner submits that to engraft onto an unambiguous statute of Congress and onto an unambiguous regulation properly adopted pursuant to that statute an exception under the "tax benefit rule" is an improper judicial function. If the purpose be to close a so-called tax "loophole" (which seems to be a popular topic of conversation during this era), then Congress certainly has it within its power to amend Sec. 337 to close that loophole. Courts should not legislate to do other than what Congress intended by an unambiguous Sec. 337.

The erroneous interpretation of the Court of Appeals in the instant case is best illustrated by the authorities relied upon in its opinion. The opinion of the Tax Court below (48 T.C. at 822, 823) clearly distinguished *Commissioner* v. *First State Bank of Stratford*, 168 F.2d 1004 (5th Cir. 1948), *cert. denied* 335 U.S. 867 (1948) and *West Seattle National Bank of Seattle* v. *Commissioner*, 288 F.2d 47 (9th Cir. 1961), and the Court of Appeals did nothing to point out any respect in which the Tax Court erred in so doing. The comments made by the Tax Court with respect to *First State Bank of Stratford* are equally applicable to

Merchants National Bank of Mobile v. *Commissioner,* 199 F.2d 657 (5th Cir. 1952). *Citizens Federal Savings and Loan Association of Cleveland* v. *United States,* 290 F.2d 932, 936 (Ct. Cl. 1961), states that the income there involved did not arise from the sale of assets. Nor was there any sale or exchange in *Alice Phelan Sullivan Corporation* v. *United States,* 381 F.2d 399, 402 (Ct. Cl. 1967) or *Lloyd H. Faidley,* 8 T.C. 1170 (1947). *Monday* v. *Commissioner,* decided January 2, 1957 (P-H Memo T.C., par. 57,001), *affirmed per curiam,* 252 F.2d 789, *cert. denied,* 358 U.S. 883, does not even remotely involve the tax benefit rule, let alone the application of the tax benefit rule to gain realized from a sale.

As stated previously in this petition the issue involved in this action is national in scope. Some indication of the scope of that issue is illustrated by a recent District Court opinion which followed the Tax Court decision in the instant case. *Spitalny* v. *United States,* 288 F.Supp. 650 (D. Ariz. 1968), on appeal to the Court of Appeals for Ninth Circuit. That decision involved a supposed deficiency in Federal taxes of $110,409.71. In an opinion written by a respected member of the judiciary who was a past president of the American Bar Association, the theory of the Tax Court's opinion in the instant case was followed completely. It is therefore apparent from the *Spitalny* case and the cases previously referred to as now pending involving this issue, that the issue is national in scope involving a considerable sum of money in the aggregate. Furthermore, the Petitioner submits that most of the cases pending on this issue can be disposed of as a matter of law, since there is usually no question that the particular item involved, such as the property rented in the instant case, was charged to expense. (Petitioner is advised for instance that the case of *S. E. Evans, Inc.* v. *U. S.,* referred to in

the table at pages 7-8 above is now pending on the motions for summary judgment on behalf of both the taxpayer and United States with the only issue of law being whether or not the tax benefit rule is an exception to Sec. 337.) Obviously, this issue apparently is one upon which members of the judiciary at the lower level will have disagreement. Also, it is an issue which will continue to recur so long as Sec. 337 remains a part of the Internal Revenue Code, said section having been at first adopted in 1954. Such being the case, the Petitioner submits that settlement of the issue involved in the instant case is plainly in the general public interest, and Petitioner further submits that a determination of whether or not a judicially engrafted exception (the tax benefit rule) can be used to modify a clear and unambiguous taxing statute passed by Congress is also in the national interest. In other words, the instant case raises an important question in the administration of the revenue laws. This court has indicated that such a question is reason enough to grant a petition for certiorari. *United States* v. *Korpan*, 354 U.S. 271 (1957), reh. den. 354 U.S. 945. There, this court stated at Page 273:

> ". . . we granted certiorari because the case raised important questions in the administration of the revenue laws. . . ."

The Petitioner further submits that the position taken by the Commissioner of Internal Revenue in the instant case represents a sudden and unwarranted change of position from a consistent administrative practice followed prior to 1961. As has been mentioned previously the regulation which the Commissioner of Internal Revenue adopted under Sec. 337 quite expressly defines property as including all assets owned by a corporation. Reg. 1.337-3(a) (Adopted 12/2/55 by T.D. 6152). Graphic evidence of the fact that the Commissioner specifically intended exactly

what he said in his regulation is contained in Rev. Rul. 59-308, *Cum. Bull.* 1959-2, Page 110, where the Commissioner had a request made to him as to the proper tax treatment of the sale of amortized emergency facilities where the sale was made by a corporation under a Sec. 337 liquidation. Deductions had been taken upon the facilities under Sec. 168 of the Internal Revenue Code over a period of 60 months, amortizing the entire adjusted basis in such assets. (In other words the assets had a zero basis.) Yet the ruling states that such property was protected by the non-recognition provisions of Sec. 337. Specifically, the ruling states at Page 111:

> "There is no provision in Sec. 1238 of the Code which requires gain to be recognized. That section only classifies part or all of the gain, when recognized, as ordinary gain rather than capital gain. Section 337 of the Code provides for the nonrecognition of the gain from the sale of property of the corporation in connection with a liquidation meeting the requirements of that section. Emergency facilities, not having been specifically excluded from the definition of 'property' as used in Section 337(a) of the Code, are included in that term."

The first departure by the Commissioner of Internal Revenue from such position was taken in Rev. Rul. 61-214, 1961-2 *Cum. Bull.*, Page 60. That ruling involved an office building corporation which adopted a plan of complete liquidation under Sec. 337. Included in the assets sold were a pile of coal, plumbing supplies and small tools. The costs of such items had been deducted in prior years. The Commissioner held that the consideration received for such items was taxable as ordinary income. Petitioner assumes that the theory of the latter ruling is that the so-called "tax benefit rule" is an exception to Sec. 337. If this be the case, it is an exception which the Commissioner did not recognize either in his regulation or in Rev. Rul. 59-308,

which ruling has never been revoked or modified by the Commissioner of Internal Revenue. Petitioner submits that to the extent that Rev. Rul. 61-214 attempts to engraft onto Sec. 337 an exception not provided by Congress, that the revenue ruling is invalid, and for the same reason that the Court of Appeals' decision is incorrect.

Petitioner's position in this regard is contained in the opinion of the Tax Court where the Court stated at 48 T.C. at Page 821 as follows:

> "In support of his contention that the tax-benefit rule is applicable here, respondent has cited Rev. Rul. 61-214, 1961-2 C.B. 60, wherein it was held that a portion of the proceeds received by an office building corporation, in a sale in complete liquidation, for a stockpile of coal, plumbing supplies, and small tools, the cost of which had been deducted in prior years, was to be treated as ordinary income under section 61 and not as nonrecognized gain under section 337(a).[4]
>
> This ruling is no more than an expression of the opinion or position of the Internal Revenue Service with respect to the law applicable to the facts recited therein and does not have the force of law. See the preface to the Cumulative Bulletin; Rogovin (then Chief Counsel, I.R.S.), 'The Four R's: Regulations, Rulings, Reliance and Retroactivity—A View From Within,' 43 Taxes 756 (Dec. 1965); *Pictorial Review Co.* v. *Helvering*, 68 F.2d 766, 768; *Radiant Glass Co.* v. *Burnett*, 54 F.2d 718, affirming 16 B.T.A. 610; *Bush* #1, 48 T.C. 218, 232.

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4. In Rev. Rul. 59-308, 1959-2 C.B. 110, respondent held that no taxable gain was to be recognized by a corporation, under sec. 337, from the sale during the period of liquidation of emergency facilities amortized under sec. 168 of the Code. In the stated case the property had been completely amortized. In that ruling respondent conceded that the facilities, not having been specifically excluded from the definition of "property" as used in sec. 337, were included in that term (Court's footnote).

> Though noted 'without comment' in *Hollywood Baseball Association*, 42 T.C. 234, 262 fn. 6, affd. 352 F.2d 350 (C.A. 9, 1965), vacated and remanded 383 U.S. 824, Rev. Rul. 61-214 has not to our knowledge been approved by any court. The conclusions reached are not supported by the authorities cited therein, are clearly contrary to the provisions of section 337(a) and, in our opinion, are not a valid interpretation of the statute. See Gutkin & Beck, 'Section 337: IRS Wrong in Taxing, at Time of Liquidation, Items Previously Deducted.' 17 J. Taxation 146."

Neither the respondent nor the Court of Appeals can seriously contend that there was no "sale" in the instant case. Neither the respondent nor the Court of Appeals can seriously argue that the sale was not of "property." The only basis upon which the position of the respondent can be sustained and upon which the decision of the Court of Appeals can be sustained is by reading into Sec. 337 a judicial exception, namely the tax benefit rule. However, such a position is in direct conflict with the Commissioner's own Reg. 1.337-3(a) and Rev. Rul. 59-308, supra, which regulation and ruling Petitioner submits are a correct interpretation of a clear and unambiguous statute created by Congress.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A-1

§ 337. Gain or loss on sales or exchanges in connection with certain liquidations

(a) General rule.—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

(b) Property defined.—

(1) In general.—For purposes of subsection (a), the term "property" does not include—

(A) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business,

(B) installment obligations acquired in respect of the sale or exchange (without regard to whether such sale or exchange occurred before, on, or after the date of the adoption of the plan referred to in subsection (a)) of stock in trade or other property described in subparagraph (A) of this paragraph, and

(C) installment obligations acquired in respect of property (other than property described in subparagraph (A)) sold or exchanged before the date of the adoption of such plan of liquidation.

(2) Nonrecognition with respect to inventory in certain cases.—Notwithstanding paragraph (1) of this subsection, if substantially all of the property described in subparagraph (A) of such paragraph (1) which is attributable to a trade or business of the corporation is, in accordance with this section, sold or exchanged to one person in one transaction, then for purposes of subsection (a) the term "property" includes—

(A) such property so sold or exchanged, and

(B) installment obligations acquired in respect of such sale or exchange.

(c) Limitations.—

(1) Collapsible corporations and liquidations to which section 333 applies.—This section shall not apply to any sale or exchange—

(A) made by a collapsible corporation (as defined in section 341(b)), or

(B) following the adoption of a plan of complete liquidation, if section 333 applies with respect to such liquidation.

(2) Liquidations to which section 332 applies.—In the case of a sale or exchange following the adoption of a plan of complete liquidation, if section 332 applies with respect to such liquidation, then—

(A) if the basis of the property of the liquidating corporation in the hands of the distributee is determined under section 334(b)(1), this section shall not apply; or

(B) if the basis of the property of the liquidating corporation in the hands of the distributee is determined under section 334(b)(2), this section shall apply only to that portion (if any) of the gain which is not greater than the excess of (i) that portion of the adjusted basis (adjusted for any adjustment required under the second sentence of section 334(b)

(2)) of the stock of the liquidating corporation which is allocable, under regulations prescribed by the Secretary or his delegate, to the property sold or exchanged, over (ii) the adjusted basis, in the hands of the liquidating corporation, of the property sold or exchanged.

APPENDIX A-2

§ 1.337-3. Property defined.—(a) Except as provided in section 337(b)(2) and this section, the term "property" as used in section 337(a) and § 1.337-1 does not include; (1) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business (hereinafter for purposes of section 337 referred to as "inventory"), (2) installment obligations acquired at any time from the sale or exchange of inventory, or (3) installment obligations acquired from the sale or exchange of property (other than inventory) prior to the adoption of the plan of liquidation. With the exceptions listed in this paragraph, the term "property" includes all assets owned by a corporation.

APPENDIX B-1

48 T. C. No. 78

TAX COURT OF THE UNITED STATES
D. B. ANDERS, Petitioner *v.* COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.
Docket No. 5094-64. Filed September 6, 1967.

An industrial laundry which provided a rental service of laundered apparels, coveralls, towels and other items, charged the cost of these items to expense when purcashed.

Most of the items had a useful life of 12 to 18 months, some longer depending upon how frequently washed and whether of seasonal use in the case of light or heavy materials. Some had the name of the employer-user and in some cases of the individual employee embroidered thereon. The corporation adopted a plan of liquidation under section 337, I.R.C. 1954, sold substantially all its property to a new corporation, and distributed its assets within 12 months to its sole stockholder. In arriving at the purchase price $233,000 was allotted to the rental items in circulating use, the cost of which had been charged to expense. *Held*: The gain realized upon the rental items in the liquidating sale is, pursuant to section 337, not recognized to the corporation.

J. Glenn Hahn and *Walter J. Kennedy*, for the petitioner.

Edward E. Pigg, for the respondent.

BRUCE, *Judge*: Respondent determined a deficiency in income tax of D. B. Anders, Inc., for the taxable year ended July 31, 1961, in the amount of $121,160 and notified petitioner that the deficiency and interest, constituting his liability as transferee of assets of the corporation, would be assessed against him. The sole issue is whether, in a liquidation under section 337 of the Internal Revenue Code of 1954, the corporation is entitled to the nonrecognition of gain on items, the cost of which has previously been deducted. Petitioner claims an overpayment.

FINDINGS OF FACT.

The stipulation of facts and the exhibits attached thereto are incorporated by reference.

D. B. Anders is an individual residing in Shawnee Mission, Kansas.

Service Industrial Cleaners, Inc. was a corporation organized in August 1947 under the laws of Kansas with its

principal offices in Kansas City, Kansas. At all times material its stock was owned by D. B. Anders directly or through his nominees. By amendment filed May 17, 1961, its name was changed to D. B. Anders, Inc. This corporation is referred to herein as "Service," or as the corporation.

Service filed a corporation income tax return for the fiscal year ended July 31, 1961, on an accrual basis, with the district director of internal revenue at Wichita, Kansas, on January 15, 1962, pursuant to an extension granted.

Service was engaged in the business of conducting and providing a rental service of cleaned and laundered towels, seat covers, fender covers, wiping materials and dust cloths, coats, coveralls, shirts, pants, and other textiles and apparels, including dusting and wiping equipment, sweeping tools, mops and accessories, herein referred to collectively as "rental items," as well as conducting a cleaning and laundering service of substantially the same type of items owned by others, and in general conducting an industrial laundry business.

For Federal income tax purposes Service charged to its expense accounts when purchased the cost of the rental items used in conducting its rental service business. At the end of each taxable year the expense accounts were credited with the costs of the ending inventory of items which had not been placed in service at the end of the taxable year.

In its taxable year ended July 31, 1961, prior to May 1961, Service had approximately 500 accounts to which it was furnishing laundry rental service. The average weekly gross income from rental and other laundry business was from $19,000 to $20,000. Some 13 percent to 20 percent of this was attributable to laundry of property of others,

referred to as NOG (not our goods). The remainder was attributable to laundry rental business.

The garment rental business was normally handled on a yearly contract basis. Service had about 40,000 garments in circulation. Most of the items had a useful life of 12 to 18 months, some longer, depending upon how frequently washed and whether of seasonal use in the case of light or heavy materials. Some had the name of the employer-user and in some cases of the individual employee embroidered thereon. Its garment customers included General Motors, Ford Motor Company, Trans World Airlines and Bendix, as well as garages, florists, filling stations, motor car dealers and small manufacturers. Its shop towel customers included railroads, pipelines, garages, filling stations, printers and paint factories. Union Pacific Railroad was serviced on a system-wide basis from Service's plants in Kansas City. Office buildings were the principal users of its dust control items. Service's replacement costs of these items averaged about $200,000 per year.

In May 1961 Anders reached an agreement for the sale of Service's business to a group of persons. The purchasers desired to carry on the business under a different corporation with the same name.

On May 12, 1961, the board of directors and the stockholders of Service adopted resolutions approving and authorizing the sale of the corporation's properties and business, changing the corporate name to D. B. Anders, Inc., and adopting a plan of complete liquidation pursuant to the terms of section 337 of the Internal Revenue Code of 1954.

As of May 16, 1961, Service entered into an "Agreement of Sale" with Albert Gitlow, Abraham Gitlow, Ben F. Singer and Joseph L. Fradkin, herein referred to as the purchasers, acting in behalf of Service Industrial Cleaners,

Inc., a Kansas corporation, formed on or about May 17, 1961, which corporation is hereinafter referred to as "Buyer."

Under the agreement, Service, as "Seller" and the named individuals, as "Purchasers" agreed to the sale and transfer to the purchasers or their assigns of all seller's inventory of the articles used in conducting the seller's rental service business, furniture and equipment, accounts receivable, interest in real property, name, routes, customers' patronage and goodwill

The price was computed in the contract as follows:

Inventory of rental items	$228,000
Furniture and equipment	88,500
Sweeping tools, mops and accessories	5,000
Good will and customer patronage	110,000
Real property	78,000
Total	$509,500

In addition, there was to be paid a sum equal to the trade accounts receivable at the close of business May 17, 1961, and prepaid items as of that date.

The parties also agreed that the foregoing price did not include new, unused and unwashed garments and rental service items, new and unused sweeping tools and washroom supplies, fuel, and new automobile and truck tires, and that there would be added to the price an amount equal to seller's cost of such items.

As of May 17, 1961, Anders entered into a covenant with the purchasers to refrain from competition with them or their corporation in the conduct of rental service or laundry business.

As of May 22, 1961, Service, then known as D. B. Anders, Inc., entered into an agreement with the pur-

chasers to a similar effect. As of the same date the corporation delivered to the buyer a bill of sale of certain of its assets. On or about May 22 or 23, 1961, the sale by the corporation of substantially all its assets to the buyer was completed.

Pursuant to the plan of liquidation the corporation distributed all its assets in complete liquidation to petitioner, its sole stockholder, within the 12-months period beginning May 12, 1961.

The corporation filed with the Secretary of State of the State of Kansas its resolution of dissolution in April, 1962, and its corporate existence ceased.

It is stipulated that the corporation is entitled to a deduction for depreciation on its building and improvements, machinery and equipment and office equipment for its taxable year ended July 31, 1961, in the amount of $7,370.77.

The corporation paid its Federal income taxes for its taxable year ended July 31, 1961, as follows:

Date Paid	Amount
October 13, 1961	$20,000.00
January 15, 1962	11,063.38

Petitioner paid additional Federal income taxes assessed against the corporation for its taxable year ended July 31, 1961, as follows:

Date Paid	Amount
May 27, 1963	$3,832.80
October 28, 1963	5,944.30

On its income tax return for the fiscal year ended July 31, 1961, the corporation reported a gain of $446,601.89 arising out of the sale of substantially all its assets to the

buyer, and claimed exclusion of such gain from taxable income under section 337, Internal Revenue Code of 1954. The gain reported included $233,000, which was the amount of the consideration received by Service from Buyer allocated to the items-in-use in its laundry rental business.

The inventory of rental items which were transferred in the sale had a basis of zero to the corporation.

OPINION

Petitioner owned all the stock of Service Industrial Cleaners, Inc., a Kansas corporation organized in 1947, which adopted a plan of liquidation in May, 1961, sold its property, changed its name to D. B. Anders, Inc., and within twelve months after the adoption of the plan distributed all of its assets in complete liquidation to him. The corporation duly filed a notice of dissolution and its existence ceased in April 1962. Petitioner received distributions in excess of the deficiency determined by respondent against the corporation for the taxable year ended July 31, 1961, and is admittedly liable as a transferee for such deficiency if the corporation is liable. Petitioner contends that under the provisions of section 337[1] no gain is to be recognized

1. SEC. 337. GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS.

(a) General Rule.—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

(b) Property Defined.—

(1) In General.—For purposes of subsection (a), the term "property" does not include—

to the corporation from the sale of its property in liquidation in May 1961.

The parties are in agreement that the corporation adopted a plan of complete liquidation after June 22, 1954 (the date specified in section 337), sold its property and distributed all its assets within the 12-month period beginning on the date the plan was adopted. They further agree that the rental items involved were not stock in trade, property includable in inventory, or property held by the corporation for sale to customers in the ordinary course of its trade or business. On the basis of these facts, it appears that there was literal compliance with the requirements of section 337(a), and further, not being property specifically excluded by section 337(b)(1), that the rental items involved were property, the gain or loss from the

---

(A) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business,

(B) installment obligations acquired in respect of the sale or exchange (without regard to whether such sale or exchange occurred before, on, or after the date of the adoption of the plan referred to in subsection (a)) of stock in trade or other property described in subparagraph (A) of this paragraph, and

(C) installment obligations acquired in respect of property (other than property described in subparagraph (A)) sold or exchanged before the date of the adoption of such plan of liquidation.

(2) Nonrecognition With Respect to Inventory In Certain Cases.—Notwithstanding paragraph (1) of this subsection, if substantially all of the property described in subparagraph (A) of such paragraph (1) which is attributable to a trade or business of the corporation is, in accordance with this section, sold or exchanged to one person in one transaction, then for purposes of subsection (a) the term "property" includes—

(A) such property so sold or exchanged, and

(B) installment obligations acquired in respect of such sale or exchange.

sale of which is not to be recognized to the corporation under section 337(a). See section 1.337-3, Income Tax Regulations; Rev. Rule. 59-120, 1959-1 C.B. 74.

Respondent contends, however, that $233,000 of the total consideration received by the corporation on the sale is includable in the taxable income of the corporation in the year of receipt, on the ground that this amount was for rental items which had previously been expensed by the corporation and it had received full tax benefit therefrom. On brief, respondent states that he "relies on the well established rule that if an amount deducted from gross income in one taxable year is recovered in a later year, the recovery is income in the later year." The rule referred to is commonly known as the "tax-benefit" rule or doctrine.

The "tax-benefit" rule was originally developed through court decisions. Mertens, Law of Federal Income Taxation (1962 Revision) section 7.34; *Estate of William H. Block*, 39 B.T.A. 338 (1939), affd. sub nom *Union Trust Co. of Indianapolis* v. *Commissioner*, 111 F. 2d 60 (C.A. 7, 1940), certiorari denied 311 U.S. 658; *Budd Company v. United States*, 252 F. 2d 456, 458 (C.A. 3, 1957). Though not expressly stated in the Code, it has received indirect statutory recognition, specifically with respect to bad debts, prior taxes and "delinquency" amounts in section 22(b)(12) of the 1939 Code, substantially re-enacted as section 111 of the 1954 Code.[2]

2. SEC. 111. RECOVERY OF BAD DEBTS, PRIOR TAXES, AND DELINQUENCY AMOUNTS.

(a) General Rule.—Gross income does not include income attributable to the recovery during the taxable year of a bad debt, prior tax, or delinquency amount, to the extent of the amount of the recovery exclusion with respect to such debt, tax, or amount.

(b) Definitions.—For purposes of subsection (a)—

* * *

T. O. McCamant, 32 T.C. 824. The "rule of exclusion" prescribed by the statute has been extended by Treasury Regulations[3] to "all other losses, expenditures, and accruals made the basis of deductions from gross income for prior taxable years * * *." For the purposes of the present case, it is not necessary to express any opinion as to whether or not the cited regulation is an unauthorized extension of the otherwise limited Congressional approval of the "tax-benefit" doctrine and we refrain from doing so. See, however, *Alice Phelan Sullivan Corp.* v. *United States*, ... F.2d ..... (Ct. Cl. July 20, 1967).

Assuming, for the purposes of this case, that the amount in question represents the recovery of expenses previously deducted from gross income by the corporation and that such recovered amount would be taxable to

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(4) Recovery Exclusion.—The term "recovery exclusion," with respect to a bad debt, prior tax, or delinquency amount, means the amount, determined in accordance with regulations prescribed by the Secretary or his delegate, of the deductions or credits allowed, on account of such bad debt, prior tax, or delinquency amount, which did not result in a reduction of the taxpayer's tax under this subtitle * * * reduced by the amount excludable in previous taxable years with respect to such debt, tax, or amount under this section.

3. Section 1.111-1, Income Tax Regs., provides as follows:

Sec. 1.111-1 Recovery of certain items previously deducted or credited.

(a) General. Section 111 provides that income attributable to the recovery during any taxable year of bad debts, prior taxes, and delinquency amounts shall be excluded from gross income to the extent of the "recovery exclusion" with respect to such items. The rule of exclusion so prescribed by statute applies equally with respect to all other losses, expenditures, and accruals made the basis of deductions from gross income for prior taxable years, including war losses referred to in section 127 of the Internal Revenue Code of 1939, but not including deductions with respect to depreciation, depletion, amortization, or amortizable bond premiums. The term "recovery exclusion" as used in this section means an amount equal to the portion of the bad debts, prior taxes, and delinquency amounts (the items specifically referred to in section 111), and of all other items subject to the rule of exclusion which, when deducted or credited for a prior taxable year, did not result in a reduction of any tax of the taxpayer under subtitle A * * *

the corporation in the year of recovery under other circumstances, it is nevertheless gain which resulted to the corporation from the sale of all its assets pursuant to a plan of complete liquidation and is nonrecognizable to *the corporation* under the provisions of section 337.

Respondent contends that by the enactment of section 337, Congress never intended the realization of such income to escape taxation at the corporate level.

The provisions of section 337 first appeared in the Internal Revenue Code of 1954. Their primary purpose was to eliminate the uncertainties attendant upon the Supreme Court decisions in *Commissioner* v. *Court Holding Co.*, 324 U.S. 331 (1945), and *United States* v. *Cumberland Public Service Co.*, 338 U.S. 451 (1950), and to permit a liquidating corporation to make a tax-free sale of all its assets with but a single tax being imposed at the stockholder level without regard to the form of the transaction. H. Rept. No. 1337, 83d Cong., 2d Sess., p. A106; *Bird Management, Inc.*, 48 T.C. 586; *Frank W. Verito*, 43 T.C. 429; *Mountain Water Co. of La Crescenta*, 35 T.C. 418.

Where, as here, application of the "tax-benefit" rule would contravene the clear and unambiguous provisions of section 337(a), we think it should not be applied. As was stated by the Supreme Court in *Lewyt Corp.* v. *Commissioner*, 349 U.S. 237, 240 (1955), "where the benefit claimed by the taxpayer is fairly within the statutory language and the construction sought is in harmony with the statute as an organic whole, the benefits will not be withheld from the taxpayer though they represent an unexpected windfall."

In support of his contention that the "tax-benefit" rule is applicable here, respondent has cited Rev. Rul.

61-214, C.B. 1961-2, 60, wherein it was held that a portion of the proceeds received by an office building corporation, in a sale in complete liquidation, for a stock-pile of coal, plumbing supplies and small tools, the cost of which had been deducted in prior years, was to be treated as ordinary income under section 61 and not as nonrecognized gain under section 337(a)).[4]

This ruling is no more than an expression of the opinion or position of the Internal Revenue Service with respect to the law applicable to the facts recited therein and does not have the force of law. See the preface to the Cumulative Bulletin; "The Four R's: Regulations, Rulings, Reliance and Retroactivity," by Mitchell Rogovin, then Chief Counsel, Internal Revenue Service, 43 Taxes 756; *Pictorial Review Co.* v. *Helvering*, 68 F. 2d 766, 768; *Radiant Glass Co.* v. *Burnett*, 54 F. 2d 718, affirming 16 B.T.A. 610; *Bush #1 c/o Stonestreet Lands Co.*, 48 T.C. 218, 232.

Though noted "without comment" in *Hollywood Baseball Association*, 42 T.C. 234 (footnote 6, p. 262), affd. 352 F. 2d 350 (C.A. 9, 1965), vacated and remanded 383 U.S. 824, Rev. Rul. 61-214 has not to our knowledge been approved by any court. The conclusions reached are not supported by the authorities cited therein, are clearly contrary to the provisions of section 337(a) and, in our opinion, are not a valid interpretation of the statute. See Gutkin and Beck, "Section 337: IRS wrong in taxing, at time of liquidation, items previously deducted." 17 Jonrnal of Taxation 146.

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4. In Rev. Rul. 59-308, C.B. 1959-2, 110, respondent held that no taxable gain was to be recognized by a corporation, under section 337, from the sale during the period of liquidation of emergency facilities amortized under section 168 of the Code. In the stated case the property had been completely amortized. In that ruling respondent conceded that the facilities, not having been specifically excluded from the definition of "property" as used in section 337, were included in that term.

In *Central Building & Loan Association*, 34 T.C. 447 (1960), the assets sold in the liquidation sale included notes receivable on which certain interest had been earned to the date of sale. This Court held there was a collection of interest rather than a "sale or exchange" of property and that such amount was not subject to nonrecognition under section 337.

In *Commissioner* v. *First State Bank of Stratford*, 168 F. 2d 1004 (C.A. 5, 1948), reversing 8 T.C. 831, certiorari denied 335 U.S. 867, a bank voted to declare a dividend in kind and distributed to its shareholders certain notes which had been charged off as worthless. At the time of distribution substantial collections had been effected on the notes and further substantial collections were effected after distribution. The Court of Appeals held the bank taxable under the anticipatory assignment of income rule. Obviously, section 337, enacted some six years later, was not involved, nor was there a "sale or exchange" of property in partial or complete liquidation.

Neither of these two cases which were cited in Rev. Rul. 61-214, support the ruling or respondent's contention with respect to the application of the "tax-benefit" rule to a sale in complete liquidation under section 337. Nor do any of the other cases cited by respondent on brief.

In *Commissioner* v. *Kuckenberg*, 309 F. 2d 202 (C.A. 9, 1962), modifying 35 T.C. 473 (1960), certiorari denied 373 U.S. 909, the Court of Appeals rejected the view that section 337 prevented the gain realized by a liquidating corporation from the sale of completed contracts from being taxable to the corporation and treated the transaction as an anticipatory assignment of earned income.

In *Pridemark, Inc.* v. *Commissioner*, 345 F. 2d 35 (C.A. 4, 1965), affirming in part and reversing in part 42 T.C. 510,

certain proceeds received for the assignment of uncompleted sales contracts for pre-fabricated houses were held not to be exempt under section 337. The Court of Appeals referred to the Tax Court holding that the sale of the contracts constituted an anticipatory assignment of income and stated:

> The uncompleted sales contracts not being capital assets, the proceeds received for their assignment are to be taxed as ordinary income.

West Seattle National Bank of Seattle, 33 T.C. 341 (1959), affd. 288 F. 2d 47 (C.A. 9, 1961), and *J. E. Hawes Corp.*, 44 T.C. 705 (1965), both involved sales of accounts receivable with respect to which reserves for bad debts had been deducted. It was held that the amount received equal to the bad debt reserves was ordinary income and section 337 did not apply because the income sought to be taxed did not represent gain from the sale of assets.

In the instant case, the rental items were the *operating assets*,—property used to generate income. They were the trees, not the fruit. The sale was of assets, not income. The fact that their income-producing potential had not been exhausted when sold did not alter their character as property used in the business of the corporation. There is no evidence of stockpiling or that the supply of rental items was not reasonable. Replacements were purchased only as needed and the business required. They were as much property used in the trade or business as the machines used to wash them or the trucks used to transport them.

Respondent has not questioned the propriety of expensing the rental items when purchased, or the fact that they were not inventoried. See section 446 (a) and (c), Internal Revenue Code of 1954; Income Tax Regulations, section 1.446-1(c)(iv); section 471, Internal Revenue Code of 1954; Income Tax Regulations, section 1.471-1.

See also *Smith Leasing Co.*, 43 T.C. 37, wherein this Court held that respondent could not require the setting up of an inventory as of the end of the year preceding liquidation.[5]

The fact that the cost of the rental items had previously been expensed does not preclude the nonrecognition of gain *to the corporation* under section 337. While there is nothing in the legislative history to indicate Congress was aware of the fact pattern of this case, the language of the statute is clear and unambiguous. If the result here is undesirable, the remedy is for Congress, not the courts. Cf. *Commissioner* v. *South Lake Farms, Inc.*, 324 F. 2d 837, 840 (C.A. 9, 1963), affirming 36 T.C. 1027. Whatever may have been the initial intention in enacting section 337, it contains no requirements other than those spelled out. Cf. *Estate of Hugh Miller*, 48 T.C. 265. In our opinion, the rental items were "property" within the definition of section 337(b)(1) and there was a "sale" of such property on or about May 22 or 23, 1961, when the transfer by Service of all its assets to Buyer was completed, pursuant to a plan of complete liquidation and the agreement of sale. Accordingly, we hold that the gain from the sale of the rental items is not to be recognized to the corporation.

In view of our holding that such gain is not to be recognized to the corporation, it follows that petitioner is not liable as transferee.

Decision will be entered under Rule 50.

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5. In this connection, it is to be noted that had the rental items-in-use been inventoried, section 337(b)(2) would have required the nonrecognition of gain *to the corporation.*

APPENDIX B-2

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

MAY 1969 TERM

No. 9,987

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

D. B. ANDERS,
Respondent.

On Petition for Review of Decision of the Tax Court of the United States

(Filed June 20, 1969)

Melva M. Graney, Department of Justice, Washington, D. C. (Mitchell Rogovin, Assistant Attorney General, and Lee A. Jackson and Meyer Rothwacks, Attorneys, Department of Justice, Washington, D. C., were with her on the brief) for Petitioner.

J. Glenn Hahn, Kansas City, Missouri (Hoskins, King, Springer, McGannon and Hahn, and Harlow B. King and Walter J. Kennedy, and Davis, Graham and Stubbs, and Robert H. Harry were with him on the brief) for Respondent.

Before PICKETT, Senior Circuit Judge, and HICKEY and HOLLOWAY, Circuit Judges.

HOLLOWAY, Circuit Judge.

This petition for review challenges the decision against the Government by the Tax Court in Anders v. Commissioner, 48 T. C. 815 (1967). The issue involved is whether the amount received for rental items of apparel, towels and the like in a sale of corporate assets preceding a complete liquidation was a gain from the sale of property within the provisions of §337 of the Internal Revenue Code of 1954 for non-recognition of gain to the corporation where the cost of such items had been fully expensed when they were purchased, or whether such gain was taxable as ordinary income to the corporation under tax benefit principles. The Government contends that due to the tax benefit obtained when the charges to expense accounts were made, the gain should be treated as ordinary income. The taxpayer[1] maintains that tax benefit principles do not apply and that there was only a gain from the sale of property within the non-recognition provisions of §337 on liquidations. The Tax Court sustained the taxpayer's position.

The undisputed facts show the following. Service Industrial Cleaners, Inc., (Service) was a Kansas corporation engaged in the business of providing a rental service of laundered towels, seat covers, wiping and dusting materials, coveralls, coats, shirts and other items of apparel. The items had a useful life of 12 to 18 months or somewhat longer depending on the use made of them. Service also carried on a general cleaning and laundering business for such items owned by others and an industrial laundry business. For Federal income tax purposes Service charged the full cost of the rental items described to expense accounts when purchased pursuant to Treasury Regulation §1.162-3 as a cost of materials and supplies. The

1. It is undisputed that respondent Anders as a stockholder received distributions in excess of the deficiency asserted against the corporation and would be liable as transferee if the corporation is liable for the deficiency.

expensed replacement cost of the rental items ran about $200,000 annually. At the end of its tax years the expense accounts were credited with the cost of items not placed in service during the year. There is no dispute as to the propriety of these charges.

In May, 1961, respondent Anders, owner of the stock of Service directly or through nominees, made an agreement for the sale of the business and properties of Service. On May 12 Service's directors and stockholders passed resolutions approving the terms of sale and adopting a plan of complete liquidation pursuant to §337. On May 16 Service executed a written agreement of sale with the individuals purchasing the business who were acting in behalf of a newly formed Kansas corporation also known as Service Industrial Cleaners, Inc., through which purchasers desired to carry on the business. On May 22 and 23 the rentals items in question and substantially all of Service's assets were sold to the purchasers. Compliance by Service with the requirements of §337 for such complete liquidations is not disputed. Moreover the parties agree that the rental items in question were not stock in trade or property includible in inventory or held for sale to customers so as to be excluded from the provisions of §337(b)(1)(A).

In the terms of sale Service agreed with the purchasers on specific consideration to be paid for the inventory of rental items in question and also specified consideration to be paid for furniture, realty, goodwill and accounts receivable. For the purposes of this opinion it is sufficient to note that Service reported a gain of $446,601 from the sale of all such property and claimed non-recognition of the gain under §337. This gain included $233,000 received for the rental items in use whose cost had been fully expensed giving them a zero basis. It is this gain from dis-

position of the rental items in use which the Government says should be taxed as ordinary income due to tax benefits obtained when the cost of the rental items was charged to expense on purchase. The tax return of Service in issue was on an accrual basis.

The Government position essentially is that §337 carries the same exceptions and limitations applicable to capital gains treatment under the Code generally, which is shown by similar definitions of property in §337 and of capital assets in §1221 and other statutory provisions;[2]

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2. §337 of the Internal Revenue Code of 1954 provided in pertinent part:

"SEC. 337. GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS.

(a) General Rule.—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

(b) Property Defined.—

(1) In General.—For purposes of subsection (a), the term 'property' does not include—

(A) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business,

(B) installment obligations acquired in respect of the sale or exchange (without regard to whether such sale or exchange occurred before, on, or after the date of the adoption of the plan referred to in subsection (a)) of stock in trade or other property described in subparagraph (A) of this paragraph, and

(C) installment obligations acquired in respect of property (other than property described in subparagraph (A)) sold or exchanged before the date of the adoption of such plan of liquidation. * * *"

that such exceptions include decisions imposing ordinary income taxation under the tax benefit rule where an amount deducted from gross income in one year is recovered in a later year; that under these principles the proceeds from the disposition of the rental items should be treated as ordinary income against which the expense of purchasing the items was charged; and that where there is no gain representing appreciation in value there is no basis for affording the transaction treatment as a gain entitled to non-recognition under §337.

The taxpayer's position in substance is that there was a sale of items constituting property within the broad definition of that term in §337 and not covered by its specified exclusions; that the tax benefit cases are of limited application, those involving anticipatory assignment of income and others relied on by the Government being inapposite, and that, in any event, the deductions taken by Service on

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In the part of the 1954 Code providing "General Rules In Determining Capital Gains And Losses," §1221 provided in pertinent part:

"SEC. 1221. CAPITAL ASSET DEFINED.

For purposes of this subtitle, the term 'capital asset' means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

(3) a copy right, a literary, musical, or artistic composition, or similar property, held by— * * *"

The Government also relies on §111 of the 1954 Code which imposed certain restrictions on application of the tax benefit rule. This provision is said to evidence legislative approval of decisions fashioning the rule. Reference is also made to a ruling which denied treatment as a non-recognizable gain in a §337 liquidation involving the sale of coal, plumbing supplies and small tools. See Rev. Rul. 61-214, 1961-2 Cum. Bull. 60.

purchase of the rental items were in the nature of depreciation deductions and not subject to recapture.

In rejecting the Government's contentions the Tax Court stated:

> "Assuming, for the purposes of this case, that the amount in question represents the recovery of expenses previously deducted from gross income by the corporation and that such recovered amount would be taxable to the corporation in the year of recovery under other circumstances, it is nevertheless gain which resulted to the corporation from the sale of all its assets pursuant to a plan of complete liquidation and is nonrecognizable *to the corporation* under the provisions of section 337." (48 T. C. at 820-821)

We do not interpret §337 as having the special effect on this transaction which the Tax Court finds. If "under other circumstances" (*i.e.*, the sale of the rental items in question without a §337 liquidation) the tax benefit rule and similar principles would have made the proceeds from the sale of such property taxable as ordinary income, they should also be taxable as ordinary income here. In §337 Congress dealt with the problem of taxation on gain to both the corporation and its stockholders where a sale of assets and subsequent liquidation occur, arising from the decisions in Commissioner v. Court Holding Co., 324 U.S. 331 (1945), and United States v. Cumberland Public Service Co., 338 U.S. 451 (1950).[3] And the means employed was to provide for non-recognition of the gain to the corporation on the sale of property (as defined in §337) by it before its liquidation. The statute used a definition of property in §337 parallel to that of assets in §1221 of the

3. See S. Rep. No. 1622, 83d Cong., 2d Sess. 258 (1954); H.R. Rep. No. 1337, 83d Cong., 2d Sess. A106 (1954); Pridemark, Inc. v. Commissioner, 345 F.2d 35 (4th Cir. 1965); and Commissioner v. Kuckenberg, 309 F.2d 202 (9th Cir. 1962), cert. denied, 373 U.S. 909 (1963).

1954 Code.[4] Moreover, there is no provision in the statute showing an intent to alter or bar the application in cases under §337 of tax benefit principles fashioned under other provisions of the Code. Therefore, we conclude that tax benefit principles are applicable here as under other statutory provisions and that §337 intended no disregard of them in liquidation cases. See Citizens Federal Savings & Loan Association of Cleveland v. United States, 290 F.2d 932 (Ct. Cls. 1961), and West Seattle National Bank of Seattle v. Commissioner, 288 F.2d 47 (9th Cir. 1961).

We turn to a consideration of this case under tax benefit principles. The rental items in question had a zero basis and their cost had been fully expensed on purchase by Service in its Federal income tax returns under Treasury Regulation §1.162-3, set out in the margin.[5] In similar circumstances a recovery of property by the taxpayer was treated as recoupment of prior charitable deductions and as taxable income. Alice Phelan Sullivan Corporation v. United States, 381 F. 2d 399, 402 (Ct. Cls. 1967). In view of Service's charging the full

4. See Pridemark v. Commissioner, supra at 45, and Merchants National Bank of Mobile v. Commissioner, 199 F.2d 657 (5th Cir. 1952), applying the tax benefit rule and denying capital gains treatment under the predecessor to §1221.

5. Service fully expensed the cost on purchase of the rental items under Treasury Regulation §1.162-3, pertaining to "Cost of Materials." which provided;

> "Taxpayers carrying materials and supplies on hand should include in expenses the charges for materials and supplies only in the amount that they are actually consumed and used in operation during the taxable year for which the return is made, provided that the costs of such materials and supplies have not been deducted in determining the net income or loss or taxable income for any previous year. If a taxpayer carries incidental materials or supplies on hand for which no record of consumption is kept or of which physical inventories at the beginning and end of the year are not taken, it will be permissible for the taxpayer to include in his expenses and to deduct from gross income the total cost of such supplies and materials as were purchased during the taxable year for which the return is made, provided the taxable income is clearly reflected by this method."

cost of the rental items to expense, the ". . . increment realized in this area over and beyond adjusted basis does not then represent any gain in capital or asset value." West Seattle National Bank of Seattle v. Commissioner, supra at 49. The *West Seattle* case involved the transfer of loans receivable at face value with recoupment thereby effected of prior bad debt charges. We conclude that the logic of tax benefit principles applies here, despite various distinctions suggested between Service's case and existing tax benefit decisions. Under such principles the proceeds of the rental items should properly be treated as recoupment of the expense charges. See Alice Phelan Sullivan Corporation v. United States, supra; Citizens Federal Savings & Loan Association of Cleveland v. United States, supra; West Seattle National Bank of Seattle v. Commissioner, supra; Commissioner v. First State Bank of Stratford, 168 F. 2d 1004 (5th Cir. 1948), cert. denied, 335 U.S. 867 (1948); Merchants National Bank of Mobile v. Commissioner, supra, at 659 (taxing proceeds of sale of notes charged off to a zero basis); William Eugene Monday, Jr., 16 T. C. M. 1, affirmed per curiam, 252 F. 2d 789 (6th Cir. 1958), cert. denied, 358 U.S. 883 (1958); Lloyd H. Faidley, 8 T. C. 1170 (1947).[6]

The taxpayer maintains that such principles may not apply since the rental items in question come literally within the general meaning of property in §337. Thus, it is argued, on disposition of the rental items the proceeds must be treated as gain from the sale of property. We do not agree. The fact that a transaction involves disposition of property does not compel treatment of the

6. But see Reynolds v. Boos, 188 F.2d 322 (8th Cir. 1951). Moreover, the Anders opinion has been followed and such tax benefit decisions held inapplicable in Spitalny v. United States, 288 F.Supp. 650 (D. Ariz. 1968), a §337 liquidation case involving charged off expenses of cattle feed and similar supplies.

proceeds as gain from such a transfer. Commissioner v. Gillette Motor Co., 364 U.S. 130, 134 (1960); United States v. Eidson, 310 F. 2d 111, 113-114 (5th Cir. 1962), modified on other grounds, 312 F.2d 744 (5th Cir. 1963); West Seattle National Bank of Seattle v. Commissioner, supra; cf. Dyer v. Commissioner, 294 F. 2d 123 (10th Cir. 1961) and Commissioner v. First State Bank of Stratford, supra. Instead, we conclude that tax benefit principles call for treatment of the proceeds not as gain from the sale of property, but as ordinary income which was deducted on its purchase.

The taxpayer contends further that the expense charges were the same as depreciation which is not subject to recapture, and that the proceeds of the rental items should be treated as gain from a sale above a depreciated basis at zero, relying on Fribourg Navigation Co., Inc. v. Commissioner, 383 U.S. 272 (1966).[7] However, the *Fribourg* case emphasizes that such treatment follows use of the depreciation method of tax accounting dealing with wear and tear or gradual expiration of the useful life of the property. Id. at 276; West Seattle National Bank of Seattle v. Commissioner, supra at 49. While some comparisons may be drawn between depreciation and the charges to expense made by Service at purchase of the rental items, we conclude that in substance the methods are not the same. By charging to expense the full cost of the rental items at purchase and not capitalizing them, there was no real depreciation method employed coming within the *Fribourg* case so as to qualify the disposition of the rental items for treatment as gain from a sale above a depreciated basis. There was no realization of ap-

7. In view of 26 U. S. C. A. §1245, this argument seems foreclosed for dispositions occurring in taxable years beginning after December 31, 1962, and involving depreciation deductions taken after December 31, 1961.

preciation in value entitled to such treatment. Commissioner v. Gillette Motor Co., supra at 134; Citizens Federal Savings & Loan Association of Cleveland v. United States, supra at 936.

As the taxpayer says, the controversy is not clearly decided by any of these cases. However, the recoupment of the charges involved here reasonably comes within the tax benefit principles and similar cases, and §337 does not alter or bar their application. In these circumstances we do not believe that treatment as a non-recognizable gain was intended by Congress.

The decision is reversed.

APPENDIX B-3

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

JULY 1969 TERM

No. 9987

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

D. B. ANDERS,
Respondent.

Order Denying Petition for Rehearing

(Filed August 6, 1969)

Melva M. Graney, Department of Justice, Washington, D. C. (Mitchell Rogovin, Assistant Attorney General, and Lee A. Jackson and Meyer Rothwacks, Attorneys, Department of Justice, Washington, D. C., were with her on the brief) for Petitioner.

J. Glenn Hahn, Kansas City, Missouri (Hoskins, King, Springer, McGannon and Hahn, and Harlow B. King and Walter J. Kennedy, and Davis, Graham and Stubbs, and Robert H. Harry were with him on the brief) for Respondent.

Before PICKETT, Senior Circuit Judge, and HICKEY and HOLLOWAY, Circuit Judges.

HOLLOWAY, Circuit Judge.

We have considered the petition for rehearing and conclude that it raises no material new issue. These comments are made due to Service's contentions, among others, that the opinion was based on reference to an incorrect regulation and that it did not discuss a pertinent alternative theory.

It is argued that the expensing of the cost of the rental items was not made under §1.162-3 of the Treasury Regulations on Income Tax dealing with the "Cost of Materials" as originally stated in the opinion. Instead, the taxpayer refers to the statement in the opinion of the Tax Court that: "Respondent has not questioned the propriety of expensing the rental items when purchased, or the fact that they were not inventoried. See sec. 446(a) and (c), I.R.C. 1954; sec. 1.446-1(c) (iv), Income Tax Regs.; sec. 471, I.R.C. 1954; sec. 1.471-1, Income Tax Regs." 48 T.C. at 823. §1.162-3 was cited by the Government brief, but we find no record proof that it was the regulation relied on by Service. The regulations cited by the Tax Court have general provisions on inventories and for use of the cash method for expense accounts by an accrual method taxpayer (which Service was) and others which do apply. We therefore consider what effect the applicability of the regulations cited by the Tax Court may have.

We note that the Tax Court findings, 48 T.C. at 816-818, in substance re-stated the following stipulation of the parties:

"6. For Federal income tax purposes Service charged to its expense accounts when purchased the cost of the items used in conducting the aforesaid rental service business. At the end of each taxable year the expense accounts were credited with the costs of the ending inventory of items which had not been placed in service at the end of such taxable year. In the sale of the business to Buyer, hereinafter referred to in paragraph 8 hereof, the sum of $233,000 of the consideration paid was allocated for the items in use."

We have considered the stipulation, the Tax Court findings to the same effect, the related facts and all the cited regulations. Accepting the proposition that Treasury Regulation §1.162-3 was not the basis of the taxpayer's expense charges, the result is the same. In any event the cost of the rental items was fully expensed at purchase and tax deductions therefor taken. The regulation permitting the deductions is not controlling. Therefore, as stated in the opinion, we conclude that under tax benefit principles the proceeds received for the rental items should properly be treated as recoupment of the prior deductions and as taxable income.

It is also contended that an alternative theory of the taxpayer was not considered. The argument is that if the rental items are not treated as property under §337(b), then they are entitled to treatment as stock in trade or other property includible in inventory under §337(b)(2). It is said that since the items were sold to one person in one transaction the taxpayer is still entitled to nonrecognition of the gain under §337(a).

The theory does not strengthen Service's position. We dealt with the contention that the rental items come literally within the general meaning of property in §337. As the opinion stated, we conclude that the fact that a transaction involves the disposition of property within the

meaning of §337 does not compel treatment of the proceeds from it as gain from a transfer of the property. The same reasoning applies if the property is treated as within the meaning of §337(b)(2). Where the cost of the property was fully expensed and deducted for tax purposes, tax benefit principles reasonably call for treatment of the proceeds as recoupment of the prior charges and ordinary income. By §337 Congress showed no intention to discard such principles.

The opinion is corrected by substituted pages 2, 3 and 8 to omit reference to Treasury Regulation §1.162-3. We also omit a statement, which followed one made in the Tax Court opinion, that the parties agreed that the rental items were not stock in trade, et cetera. This is done to show that the taxpayer has asserted the alternative theory under §337 (b) (2), discussed above.

We conclude that neither the grounds discussed above nor others urged warrant a rehearing or altering the decision. The petition for rehearing is denied.

In the Supreme Court of the United States

OCTOBER TERM, 1969

No. 583

D. B. ANDERS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (Pet. A3–A17) are reported at 48 T.C. 815. The opinion of the court of appeals (Pet. A18–A27) and the court's order denying the petition for rehearing (Pet. A28–A31) are not yet officially reported.

JURISDICTION

The judgment of the court of appeals was entered on June 20, 1969, and its order denying the petition for rehearing was entered on August 6, 1969. The petition for a writ of certiorari was filed on Septem-

368-237—69

ber 12, 1969. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, upon a sale of corporate assets preceding a complete liquidation under Section 337 of the Internal Revenue Code, the amount received for rental items, the cost of which had previously been deducted from ordinary income, is taxable as ordinary income under the tax benefit rule.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Section 337 of the Internal Revenue Code of 1954 and Section 1.337–3 of Treasury Regulations on Income Tax (1954 Code) are set forth in the Appendix, *infra*, pp. 9–10.

STATEMENT

Service Industrial Cleaners, Inc. ("Service") was engaged in the business of providing a rental service of laundered towels, seat covers, wiping and dusting materials and various items of apparel. These items had a useful life of 12 to 18 months or somewhat longer depending on the use made of them. Service also carried on a general cleaning and laundering business for such items owned by others and an industrial laundry business. (Pet. A19.)

For federal income tax purposes Service charged the full cost of the rental items to its expense accounts at the time of acquisition. At the end of its tax years the expense accounts were credited with the cost of items not placed in service during the year,

with the result that Service obtained a current deduction for all items that had been placed in service during the year. There is no dispute as to the propriety of these procedures. (Pet. A19–A20.)

In May, 1961, petitioner, the owner of Service's stock, entered into an agreement for the sale of the business and properties of Service. Service's directors and stockholders approved the terms of sale and adopted a plan of complete liquidation pursuant to Section 337 of the Internal Revenue Code of 1954 (Appendix, *infra*, pp. 9–10). In accordance with the above, the rental items and substantially all of Service's assets were sold to the purchasers.[1] (Pet. A20.)

In the terms of sale Service agreed with the purchasers on the specific consideration to be paid for the inventory of rental items and also for furniture, realty, goodwill and accounts receivable. Service reported a gain of $446,601 on the sale and claimed nonrecognition of this gain under Section 337. The gain included $233,000 received for the rental items in use, the cost of which had previously been deducted from ordinary income. The government contended that the $233,000 should be taxed as ordinary income under the tax benefit rule since the rental items had been charged to expense on purchase and deducted (Pet. A20–A21). The Tax Court held that the $233,000

[1] There is no dispute as to Service's compliance with the requirements of Section 337 for a complete liquidation. Moreover, the parties agree that the rental items were not stock in trade or property includible in inventory or held for sale to customers, within the meaning of Section 337(b)(1)(A) of the 1954 Code. (Pet. A20.)

constituted nonrecognizable (and therefore nontaxable) gain under Section 337 (Pet. A9–A17), and the court of appeals reversed (Pet. A18–A27, A28–A31).

ARGUMENT

The decision of the court of appeals is correct; there is no conflict of decisions, and no other occasion for further review by this Court.

1. Section 337(a) of the Internal Revenue Code provides generally for the nonrecognition of gain realized from the sale of "property" in connection with certain liquidations. Section 337(b) sets forth certain categories of "property" excepted from the Section 337 (b) definition of that term, the gain on the sale of which is recognizable. Although Section 337(b) does not specifically refer to the tax benefit rule, the court of appeals correctly concluded (Pet. A24) that there was "no provision in the statute showing an intent to alter or bar the application in cases under Section 337 of tax benefit principles fashioned under other provisions of the Code." Accordingly, the court below held that the proceeds from the disposition of the previously expensed rental items should be treated as ordinary income. In so holding, it rejected petitioner's contention to the effect that the tax benefit rule did not apply here because the rental items in question fell literally within the general meaning of "property" in Section 337.

2. The decision of the court of appeals is consistent with the tax benefit rule,[2] as applied by this Court and

[2] The tax benefit rule was first developed through court decisions and was subsequently added to the Code itself. See

other courts, the rationale of which is that if an item has previously served to offset taxable income, its recoupment should be treated as a recovery of income. *United States* v. *Skelly Oil Co.*, 394 U.S. 678, 686 n. 5; *Alice Phelan Sullivan Corp.* v. *United States*, 381 F. 2d 399, 401–403 (Ct. Cl.); *O'Meara* v. *Commissioner*, 8 T.C. 622, 634–635. Specifically, the tax benefit rule has been held to require the restoration to income of accrued deductions which are subsequently recovered in the very situation presented here, *viz.*, a corporation selling all of its assets and liquidating under Section 337. The decision below thus follows other cases recognizing that the policy of the tax benefit rule is applicable to a liquidating corporation, notwithstanding its qualification under the nonrecognition of gain provisions of Section 337. *West Seattle National Bank of Seattle* v. *Commissioner*, 288 F. 2d 47 (C.A. 9); *Citizens Federal S. & L. Ass'n of Cleveland* v. *United States*, 290 F. 2d 932, 936–938 (Ct. Cl.)[3] Petitioner has cited no court of

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Section 111 of the 1954 Code. While that provision refers only to the recovery of certain items, such as bad debts, prior taxes or delinquency amounts, Section 1.111–1 of the Treasury Regulations extends the rule to the recovery of other deducted items. The Regulations are valid as a clarifying interpretation of the Code provision. See 1 Mertens, *Law of Federal Income Taxation* (Rev.), Sections 7.34, 7.37, pp. 84–86, 95. See also *Alice Phelan Sullivan Corp.* v. *United States*, 381 F. 2d 399, 402–403 (Ct. Cl.); *Monday* v. *Commissioner*, decided January 2, 1957 (P–H Memo T.C., par. 57,001), affirmed *per curiam*, 252 F. 2d 789 (C.A. 6), certiorari denied, 358 U.S. 883; *Faidley* v. *Commissioner*, 8 T.C. 1170.

[3] The issue in this case is to be contrasted with the question presented in *Nash* v. *United States*, 414 F. 2d 627 (C.A. 5), pending on taxpayers' petition for certiorari, No. 678, this Term,

appeals decision to the contrary, and we are unaware of any such decision.[4]

3. The decision of the court of appeals also is consistent with the purpose of Section 337. Petitioner's contention (Pet. 9–14) that the tax benefit rule does not apply in Section 337 cases necessarily rests upon a literal definition of the term "property" in the statute. It fails to recognize, as the court below held (Pet. A23–A24), that the gain from the sale of property to which Section 337 accords nonrecognition treatment is gain which otherwise would be taxed at capital gains rates.[5] Since the gain that would be

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in which the government has acquiesced. The issue in *Nash* is whether a partnership's unused reserve for bad debts is required to be restored to income upon the transfer of all of its assets to a controlled corporation in exchange for stock under Section 351 of the Code. Unlike the instant case where there was a sale of corporate assets at fair market value to an unrelated third party, *Nash* involves a transfer of assets to a corporation, the shareholders of which were members of the partnership which previously held the assets. See *Estate of Schmidt* v. *Commissioner*, 355 F. 2d 111, 113–114 (C.A. 9).

[4] None of the cases referred to by petitioner (Pet. 7–8) have been decided, except *Spitalny* v. *United States*, 288 F. Supp. 650 (D. Ariz.), in which the district court held that a corporation could treat the amount received from the sale of feed and other supplies on hand in a liquidating sale as nonrecognizable gain under Section 337. An appeal has been filed by the United States to the Ninth Circuit. The case awaits argument and decision in the court of appeals.

[5] The history underlying the enactment of Section 337 demonstrates that it was designed to eliminate the double incidence of capital gains taxation on a sale of assets by a liquidating corporation—once when the corporation sold its assets and again on distribution of the proceeds to its shareholders in liquidation. The old rule required such double taxation when the sale was accomplished by the corporation rather than the shareholders. See H. Rep. No. 1337, 83d Cong., 2d Sess., p. A106

realized upon a disposition of the rental items in question would be considered ordinary income (because the cost of the items had previously been deducted from ordinary income), such gain cannot qualify for nonrecognition treatment under Section 337. See *Williamson* v. *United States*, 292 F. 2d 524 (Ct. Cl.); *Commissioner* v. *Kuckenberg*, 309 F. 2d 202 (C.A. 9); *Family Record Plan, Inc.* v. *Commissioner*, 309 F. 2d 209 (C.A. 9).[6]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

ERWIN N. GRISWOLD,
Solicitor General.
JOHNNIE M. WALTERS,
Assistant Attorney General.
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Attorneys.

NOVEMBER, 1969.

(3 U.S.C. Cong. & Adm. News (1954) 4017, 4244); S. Rep. No. 1622, 83d Cong., 2d Sess., p. 258 (3 U.S.C. Cong. & Adm. News (1954) 4621, 4896). Compare *Commissioner* v. *Court Holding Co.*, 324 U.S. 331 with *United States* v. *Cumberland Pub. Serv. Co.*, 338 U.S. 451.

[6] Petitioner's reliance (Pet. 17) on the Commissioner's ruling (Rev. Rul. 59-308, 1959-2 Cum. Bull. 308) relating to amortized emergency facilities is misplaced. As the court of appeals observed (Pet. App. A26), the expensing of rental items cannot be equated with the gradual exhaustion of an asset. Moreover, the question of the treatment of depreciation under Section 337 has largely been mooted by the enactment in 1962 of Section 1245 of the Code (Pet. App. A26 n. 7).

APPENDIX

Internal Revenue Code of 1954:

SEC. 337. GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS.

(a) *General Rule.*—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

(b) *Property Defined.*—

(1) *In general.*—For purposes of subsection (a), the term "property" does not include—

(A) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business,

(B) installment obligations acquired in respect of the sale or exchange * * * of stock in trade or other property described in subparagraph (A) of this paragraph, and

(C) installment obligations acquired in respect of property (other than prop-

erty described in subparagraph (A)) sold or exchanged before the date of the adoption of such plan of liquidation.

(2) *Nonrecognition with respect to inventory in certain cases.*—Notwithstanding paragraph (1) of this subsection, if substantially all of the property described in subparagraph (A) of such paragraph (1) which is attributable to a trade or business of the corporation is, in accordance with this section, sold or exchanged to one person in one transaction, then for purposes of subsection (a) the term "property" includes—

(A) such property so sold or exchanged, and

(B) installment obligations acquired in respect of such sale or exchange.

* * * * * *

(26 U.S.C. 337.)

Treasury Regulations on Income Tax (1954 Code):

Sec. 1.337–3. PROPERTY DEFINED.

(a) Except as provided in section 337(b)(2) and this section, the term "property" as used in section 337(a) and § 1.337–1 does not include, (1) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business (hereinafter for purposes of section 337 referred to as "inventory"), (2) installment obligations acquired at any time from the sale or exchange of inventory, or (3) installment obligations acquired from the sale or exchange of property (other than inventory) prior to the adoption of the plan of liquidation. With the exceptions listed in this paragraph the term "property" includes all assets owned by a corporation.

* * * * * *

(26 C.F.R. 1.337–3.)

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1969

No. 583

D. B. ANDERS,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

REPLY BRIEF BY PETITIONER TO THE BRIEF FOR THE RESPONDENT IN OPPOSITION

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REPLY BRIEF BY PETITIONER TO THE BRIEF FOR THE RESPONDENT IN OPPOSITION

The opinion of the Court of Appeals for the Tenth Circuit is reported at 414 F.2d 1283. The revised opinion, denying the petitioner's petition for rehearing is reported immediately following that opinion at 414 F.2d 1289.

This reply brief is limited to one item of new matter raised by the brief for the respondent in opposition, which new matter is totally incorrect.

The brief for the respondent in opposition reflects respondent's continuing failure here, as in the court below, to observe his duty to inform the court clearly and concisely of the legal issues in this case.

The following statement in brief for respondent is false:

> ". . . Moreover, the parties agree that the rental items were not stock in trade or property includible in inventory or held for sale to customers, within the meaning of Section 337(b)(1)(A) of the 1954 Code." (Pet. A 20).

This sentence appeared in the original opinion of the United States Court of Appeals, Tenth Circuit. Petitioner's Petition for Rehearing pointed out to the court that such statement was *not true* because petitioner had always contended in the alternative that if the rental items were not *property*, then they *were* stock in trade or inventory, and because they were sold to one person in one transaction, the gain was not recognized under Internal Revenue Code, Section 337(b)(2). See Petition for Rehearing. See also Petition for Certiorari, p. 11.

In its Order Denying Petition for Rehearing the Tenth Circuit expressly withdrew from its opinion the statement cited by respondent above. (Pet. A 31). Respondent's repetition of such statement in its brief is therefore totally incorrect.

CONCLUSION

For the reasons stated in the Petition for Certiorari, which are hereby reaffirmed, the petition should be granted. It is submitted that the brief for the respondent in opposi-

tion is based upon untenable grounds and does not state any cogent or valid reason why the petition should be denied.

Respectfully submitted,

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PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1969

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D. B. ANDERS,
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vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Petitioner prays that this Court grant rehearing of its order of December 8, 1969, denying the Petition for Writ of Certiorari, and requests that a writ of certiorari issue to review the judgment of the Court of Appeals for the Tenth Circuit in the above-entitled case as prayed for in the petition filed herein by the petitioner on September 12, 1969.

REASON FOR GRANTING REHEARING AND ISSUING THE WRIT

As mentioned in the Petition for Certiorari filed herein (at Page 7), there is currently pending before the Court of Appeals for the Ninth Circuit a case involving the same issue involved in the instant case. Petitioner is advised that the case before the Court of Appeals for the Ninth Circuit (*Spitalny* v. *U. S.*) will be orally argued before that Court in the near future. Petitioner submits that its Petition for Certiorari filed herein and its reply brief filed herein graphically indicate that the issue involved in the instant case is of significant national importance and that should the *Spitalny* case be decided contrary to the instant case, the petitioner would be placed in the anomalous position of having been denied certiorari, followed by an immediate split in the Courts of Appeal, during which time the petitioner's time to file a petition for rehearing would have lapsed.

The petitioner therefore requests of the Court that it grant rehearing on the Petition for Certiorari filed herein to the extent of awaiting disposition of the *Spitalny* case by the Court of Appeals for the Ninth Circuit. Should the Court of Appeals for the Ninth Circuit rule in taxpayer's favor in the *Spitalny* case, petitioner submits that there would at that time be a clear difference between two Courts of Appeals on the same issue and that this Court at that time should give serious consideration to granting the writ of certiorari in the instant case.

In support of this petition for rehearing the petitioner calls the Court's attention to the decision by the Court of Appeals for the Ninth Circuit in the case of *Commissioner*

of Internal Revenue v. *South Lake Farms, Inc.*, 324 F.2d 837 (9th Cir. 1963). In that case the Court had before it a liquidation which had occurred under Sec. 336 of the Internal Revenue Code (clearly a companion statute to Sec. 337), in which the Court of Appeals for the Ninth Circuit refused to follow the tax benefit rule. The only difference between the instant case and the *South Lake Farms* case was that in *South Lake Farms* a corporation sold its stock to another corporation. Following the acquisition the acquiring corporation liquidated the old corporation under Sec. 334(b)(2) of the Internal Revenue Code of 1954. The cost of raising barley and cotton had been deducted by the taxpayer corporation prior to the sale of its stock. There the Commissioner of Revenue argued that the tax benefit rule should be applicable, but the Court of Appeals for the Ninth Circuit refused to apply the tax benefit rule. The Court of Appeals indicated that if this is an undesirable result the remedy is for Congress, not the Courts.

Petitioner submits that the ruling in *South Lake Farms, Inc.* certainly is some indication of the fact that the Court of Appeals for the Ninth Circuit has previously rejected the application of the tax benefit rule to a corporate liquidation statute. It is therefore not farfetched on the part of petitioner to submit that at the very least the Court in the *Spitalny* case will be confronted with deciding whether or not their reasoning as applied to Sec. 336 of the Code in the *South Lake Farms* case is also applicable to Sec. 337. If that Court should agree that it is, its decision will be contrary to the Court of Appeals in the instant case and a clear split of authority will have developed.

In the event of such a split of authority, at which time the time for a petition for rehearing under this Court's

rules would have expired, the petitioner will be in the unjust position of having been denied certiorari within a very short time prior to the time that a split of authority developed. Petitioner submits that such an anomaly should not be countenanced by this Court and that the petition for rehearing should be granted to the extent of awaiting the ruling of the Court in the *Spitalny* case before the petition for certiorari in the instant case is finally ruled upon.

Furthermore, the net effect of the *South Lake Farms* case in the Ninth Circuit and the instant case in the Tenth Circuit is to repeal Sec. 337. As stated in petitioner's Petition for Certiorari, the purpose in passing Sec. 337 was to eliminate a distinction in corporate liquidations between whether a sale was made in connection with such liquidation by the corporation or the stockholders. The net effect of the ruling in *South Lake Farms* is that the stockholders, in a hypothetical sale following a liquidation distribution, can make the sale without fear of application of the tax benefit rule. On the other hand, under the *Anders* case, if the corporation makes the sale then the tax benefit rule is applicable. The effect of these two decisions at one fell swoop is to bring back the fine distinction in the law which Congress thought it was eliminating by the 1954 Code.

CONCLUSION

For the reasons set forth above and in its petition for writ of certiorari, it is respectfully urged that rehearing be granted, to await the decision of the Court of Appeals for the Ninth Circuit in the *Spitalny* case and that upon such rehearing, if a split of opinion develops between the Court of Appeals for the Tenth and Ninth Circuits that

a writ of certiorari issue to the Court of Appeals for the Tenth Circuit.

Respectfully submitted,

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CERTIFICATE OF COUNSEL

I hereby certify that the foregoing petition for rehearing is presented in good faith and not for delay and is restricted to grounds specified in Rule 58 of the rules of this Court.

.....

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